COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Southern Union Company	)	D.T.E. 01-52

BRIEF OF SOUTHERN UNION COMPANY

Submitted by:

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I. INTRODUCTION

On May 17, 2001, Southern Union Company ("Southern Union" or the "Company")[1] filed a petition (the "Petition") with the Department of Telecommunications and Energy (the "Department") for approval and authorization, pursuant to G.L. c. 164, § 11 (as amended), and § 14, to issue and distribute up to 2.7 million shares of common stock.[2]

As discussed herein, the record in this proceeding shows that the Company has met the Department's two-part standard under G.L. c. 164, §§ 14 and 16 for the approval and authorization of a common stock issuance. Accordingly, the Department should approve the Company's request to issue up to 2.7 million shares of common stock for the purpose of providing a dividend payment to the Company's equity shareholders.

1 On September 28, 2000, Southern Union Company, a Delaware corporation with its principal offices located in Austin, Texas, completed its acquisition of Fall River Gas Company ("Fall River") and Providence Energy Corporation and its operating subsidiary, North Attleboro Gas Company ("North Attleboro"). As a result, Fall River and North Attleboro are now operating as part of the New England division of Southern Union.

2 As discussed below, G.L. c. 164, § 11 currently prohibits the declaration of a stock dividend. However, at this writing, legislation in the enactment stage would amend § 11 to eliminate the statutory prohibition and would provide the Department with the authority under G.L. c. 164, § 14 to review and approve the issuance of common stock for the purpose of effecting the proposed stock-dividend payment.

II. PROCEDURAL HISTORY

Subsequent to the filing of the Companies' proposal, the Office of the Attorney General (the "Attorney General") intervened in the proceeding. The Department conducted a public and evidentiary hearing at its offices on June 26, 2001. At the evidentiary hearing, the Company presented one witness: Cheryl F. Yager, Assistant Treasurer of Southern Union, who testified in support of the Company's request for authorization to issue up to 2.7 million shares of common stock.

The evidentiary record consists of approximately 28 documentary exhibits, including the initial filing and the Company's responses to information and record requests, as well as the sworn testimony presented at hearing. The Hearing Officer established a briefing schedule requiring the filing of the Company's brief, including its response to one briefing question posed by the Department, on July 2, 2001.[3] In addition, the Hearing Officer determined that all other briefs must be filed no later than July 10, 2001.

III. DESCRIPTION OF THE PROPOSED STOCK ISSUANCE

A. Issuance of Common Stock

In this filing, Southern Union seeks authorization under G.L. c. 164, § 14 for the issuance and distribution of up to 2.7 million shares of common stock for the purpose of providing a dividend payment to the Company's equity shareholders (Exh. SU-1, at 3). Based on approximately 50,982,000 shares outstanding as of March 31, 2001, the issuance of up to 2.7 million shares would constitute a 5 percent common-stock dividend to shareholders (id.).

Southern Union initiated its stock dividend policy in 1994 following a corporate reorganization and has issued a stock dividend in each of the past seven years (id. at 4; Tr. at 64). In recent years, the Board of Directors has declared the dividend in June of each year as a percentage of outstanding shares of stock (Exh. SU-1, at 4). In declaring the dividend, the Board also sets a record and payment date and authorizes the issuance of shares to accomplish the stock dividend (id.). The stock dividend is announced to shareholders on the declaration date and is paid to all holders of Southern Union stock as of the record date, which is generally set 10 days after the declaration date (id.). The payment date generally follows the record date by 10 days to two weeks (id.).

The Company has in place a Stock Dividend Sale Plan (the "Sale Plan"), which provides eligible owners of the Company's common stock the opportunity to sell shares that are received as stock dividends (id. at 8; Tr. at 31-38). Under this plan, shareholders may elect, at a point prior to the record date, to sell shares that are issued to them as a dividend through the Sale Plan (id.). There are no costs to the shareholders associated with this election (id.). The Sale Plan is administered by a Plan Broker, who aggregates the dividend shares offered for sale and sells the shares on the open market over an extended time period of two-to-four weeks (id.). Shareholders participating in the plan receive payment for their shares based on the average price obtained for the aggregated shares over the allotted time period (id.).

(…footnote continued)

[3] The Company's response to the briefing question posed by the Department is set forth in section VI, infra.

Historically, less than 2 percent of the shares issued as a stock dividend were sold by shareholders through Sale Plan (Exh. SU-6).

In addition to Massachusetts, Southern Union operates in Texas, Rhode Island, Missouri, Pennsylvania and Florida (Exh. SU-1, at 2). Other than Massachusetts, no state in which the Company operates prohibits a utility from declaring a stock dividend (id. at 5, 9-10). In Massachusetts, G.L. c. 164, § 11 currently prohibits the payment of a stock dividend (id. at 5; Exh. SU-2). However, section 11 was enacted in its present form in 1914 when utility rates were established based upon the total capitalization of the company, and therefore, the laws relative to security issues were designed to regulate a company's overall capitalization (Exh. SU-2, at 5). Subsequent to the enactment of Section 11, the model for setting utility rates was modified and a rate-base calculation is now used to set rates rather than a utility's total capitalization (id.). In addition, the Department has the authority to approve stock issuances, where the proponent of such an issuance meet the requirements of G.L. c. 164, §§ 14 and 16 (id. at 3).

Given that the underlying purpose of section 11 is no longer germane, and because the prohibition impairs the Company's ability to continue a valued corporate practice that is allowed in every other jurisdiction in which the Company operates, Southern Union initiated an effort to secure a legislative change to the statute (Exh. SU-1, at 5). The proposed legislation would eliminate the statutory prohibition on the issuance of a stock dividend and would provide the Department with the authority to review the associated stock issuance under G.L. c. 164, §§ 14 and 16 (id. at 5-6; Exh. SU-2, at 1, 3). Because the prohibition on the payment of stock dividends must be eliminated before the Department can approve Southern Union's petition in this proceeding, Southern Union has requested that the Department condition its approval upon the enactment of the proposed legislation (Exh. SU-1, at 6).

As discussed below, the record shows that the Company's proposal meets the requirements of the Department's two-pronged test for the approval of stock issuances, and therefore, the Company's petition should be granted subject to two conditions: (1) legislative enactment of an amendment to G.L. c. 164, § 11 (Exh. SU-1, at 6; Tr. at 71);[4] and (2) certification of the Board of Director's vote authorizing the issuance of stock for the purpose of effecting the stock dividend (Exh. SU-1, at 3).

B. Capital Structure of the Company

As of March 31, 2001, the Company's utility plant in service was $2,102,147,000, with accumulated depreciation of $733,584,000, resulting in net utility plant of $1,368,563,000, or $1,395,396,000, including gas inventories held by regulated utilities in the amount of $26,833,000 (Exh. SU-3). As of March 31, 2001, the Company reported a total capitalization of $1,264,710,000, including retained earnings of $46,150,000, which will be reclassified to common stockholders' equity following the issuance of the stock dividend (Exh. SU-3; Exh. SU-4 (revised); Exh. SU-15). The Company's total capitalization consists of: (1) long-term debt and capital-lease obligations of $784,494,000 (excluding the outstanding balance of a 364-day term loan and the pending $400 million issuance of long-term debt approved by the

[4] This condition assumes that the legislation has not been enacted at the time that the Department issues its decision in this proceeding.

Department in Southern Union Company, D.T.E. 01-32 (2001));[5] (2) common stock of $417,509,000 (including adjustments associated with the stock issuance and dividend payment); and (3) preferred stock of $62,707,000 (Exh. SU-3). In addition, as described below, various adjustments have been made to total capitalization resulting in a reduction to capitalization of $962,744,000 (Exh. SU-1, at 13-18; Exh. SU-3; Exh. SU-4 (revised)). Accordingly, Southern Union's net-utility plant will be in excess of total capitalization by $130,686,000 after the proposed issuance of up to 2.7 million shares of common stock and the payment of the stock dividend (Exh. SU-3).

As set forth in Exhibit SU-4 (revised), the foregoing capital structure incorporates four adjustments to the Company's consolidated balance sheet for the purpose of comparing the post-issuance, net-utility plant to total capitalization. These adjustments, totaling $962,744,000, are as follows: (1) a net reduction in the Long-Term Debt and Capital Lease Obligation in the amount of $123,000,000 representing the outstanding balance of the 364-day term loan following the $400 million long-term debt issuance approved by the Department in D.T.E. 01-32 (which equals the current outstanding balance of $85 million plus $38 million retired by the Company since March 31, 2001), (Exh. SU-1, at 14; Exh. SU-4 (revised); Exh. SU-21; Tr. at

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[5] The Company has submitted a revised Exhibit SU-4 to reflect that, as of the hearing date (June 26, 2001), the total outstanding balance of the 364-term loan is approximately $85 million, rather than the $123 million outstanding as of March 31, 2001 (see Tr. at 21).

21);[6] (2) a reduction to Property, Plant and Equipment (plant in service) of $50,883,000 reflecting the removal of property, plant and equipment relating to unregulated business operations (Exh. SU-1, at 14-15); (3) a reduction to Property, Plant and Equipment (plant in service) of $733,921,000 reflecting the removal of Additional Purchase Cost Assigned to Utility Plant (net of amortization) (Exh. SU-1, at 16);[7] and (4) the removal of Accumulated Other Comprehensive Income ($54,940,000), which is related to a Current Asset item on the balance sheet and not to the Company's Property, Plant and Equipment (Exh. SU-1, at 17-18; Exh. SU-4 (revised)). The Department previously considered and approved all of these adjustments in the Company's recent long-term financing case. D.T.E. 01-32, at 10-11.

IV. STANDARD OF REVIEW

For the Department to approve the issuance of stock, bonds, coupon notes or other types of long-term indebtedness[8] by an electric or gas company, the Department must

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6 In Exhibit SU-4 (revised), the Company reduced its total Long-Term Debt and Capital-Lease Obligation of $1,374,036,000 as reported in its Form 10K for the period ending March 31, 2001, by $523,000,000, which represents the outstanding balance of the Company's 364-day term loan of $85 million; the retirement of $38 million of the total outstanding balance of the term-loan as of March 31, 2001, and the conversion of $400 million of the term loan to long-term debt (Exh. SU-1, at 14; Tr. at 21). For the purpose of calculating the Department's net-plant test in Exhibit SU-3, the Company added back $400 million in long-term debt obligations that will result from the issuance of its long-term debt, for a net reduction to Long-Term Debt and Capital-Lease Obligation of $123,000,000 (Exh. SU-3).

7 The reductions to capitalization associated with the removal of plant in service for unregulated operations ($50,883,000) and the Additional Purchase Cost ($733,921,000) were accomplished by reducing outstanding debt and equity (both common and preferred) in the same ratio as those categories of capital have in relation to the Company's total capitalization, exclusive of the $523 million (now $485 million) that is listed on the Company's consolidated balance sheet as long-term debt, but which is, in actuality, a short-term obligation (Exh. SU-1, at 15-17; Exh. SU-4 (revised); Exh. SU-15).

8 "Long-term" refers to periods of more than one year after the date of issuance. See, e.g., Boston Edison Company, D.T.E. 00-62, at 2, fn.2.

determine that the proposed issuance satisfies two requirements. First, the Department must assess whether the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. Boston Edison Company, D.T.E. 00-62, at 2 (2000); Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II"), citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). Second, the Department must determine whether the Company has met the net plant test.[9] Colonial Gas Company, D.P.U. 84-96 (1984).

The Supreme Judicial Court has found that, for the purposes of G.L. c. 164, § 14, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946). In cases where no issue exists about the reasonableness of management decisions regarding the requested financing, the Department limits its section 14 review to the facial reasonableness of the purpose to which the proceeds of the proposed issuance will be put. Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990). Regarding the net plant test, a company is required to present evidence that its net utility plant (original cost

9 The net plant test is derived from G.L. c. 164, § 16. When the Department approves an issue of new stock, bonds or other securities by a gas or electric company, if it determines that the fair structural value of the plant and of the land and the fair value of the nuclear fuel, gas inventories or fossil fuel inventories owned by such company is less than its outstanding stock and debt, it may prescribe

(footnote continued…)

of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Colonial Gas Company, D.P.U. 84-96, at 5 (1984).

V. THE COMPANY'S PROPOSAL MEETS THE DEPARTMENT'S STANDARD OF REVIEW UNDER G.L. c. 164, §§ 14 and 16.

As set forth above, the Company has the burden in this proceeding to demonstrate that the common-stock issuance: (1) is reasonably necessary to accomplish a legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14; and (2) that the its net utility plant equals or exceeds its total capitalization (as determined by application of the Department's net-plant test) and will continue to do so following the proposed issuance, pursuant to G.L. c. 164, § 16. See New England Power Company, D.T.E. 00-53, at 10; Boston Edison Company, D.T.E. 00-62, at 9-10. In this proceeding, the Company has satisfied this burden, and therefore, the Department should authorize and approve the Company's request to issue up to 2.7 million shares of common stock.

A. The Company Has Demonstrated That the Issuance Is Reasonably Necessary to Accomplish a Legitimate Utility Purpose

The record shows that the issuance of 2.7 million shares of common stock to provide a dividend payment to the Company's equity shareholders serves the interests of both customers

(…footnote continued)

such conditions and requirements as it deems best adapted to make good within a reasonable time the impairment of the capital. See G.L. c. 164, § 16.

and shareholders by providing the Company with a cost-effective means of attracting, acquiring and maintaining equity capital for the funding of capitalizable additions, extensions, and improvements to its utility plant and property (Exh. SU-1, at 7-8; Exh. SU-22; Tr. at 80-82). As structured by Southern Union, the payment of a stock dividend to shareholders has attributes of both a dividend reinvestment plan and a stock split. Therefore, although the issuance of stock for the purpose of effecting a stock dividend has not been previously considered by the Department per se, there is well-settled and applicable case precedent as to the "legitimate utility purpose" of issuing stock for the purpose of "acquiring and maintaining equity capital at a modest expense" and for the purpose of increasing the "liquidity and marketability" of a company's common stock. See respectively, Colonial Gas Company, D.P.U. 91-130 at 4 (1991) (approving a stock issuance under a dividend reinvestment plan); Fall River Gas Company, D.P.U. 93-147/93-172, at 7 (1993) (approving stock split). Since Southern Union's stock-dividend policy serves both of these objectives, the issuance of stock to effect the dividend payment meets the first prong of the Department's two-part standard, and therefore, should be approved.

Specifically, the record shows that the primary objective (and benefit) of the stock dividend is that it allows the Company to retain earnings to fund capitalizable additions, extensions, and improvements to its utility plant and property (Exh. SU-1, at 7; DTE-RR-1;

DTE-RR-6; Attachment DTE-RR-4(b) at 13; Tr. at 80-82).[10] In the past, the Department has approved a variety of dividend-reinvestment plans for most, if not all, of the gas and electric utilities operating in the Commonwealth. Under a dividend-reinvestment plan, a company's shareholders may elect to have their cash dividends automatically reinvested in additional shares of common stock, which are specifically issued by the company for sale through the plan. Utilities have adopted these plans because they provide a utility with "a means to provide a continuous infusion of new equity capital into the company in a cost-effective fashion." Colonial Gas Company, D.P.U./D.T.E. 97-83, at 2 (1997). Thus, in approving the issuance of stock necessary to administer these plans, the Department has found that the issuance serves a legitimate utility purpose because the proceeds from the sale of shares through the plan are available to fund additions to utility plant and to retire short-term debt incurred for the same purpose. See e.g., Colonial Gas Company, D.P.U. 91-130, at 4 (1991); Bay State Gas Company, D.P.U. 91-170, at 6 (1991); Boston Edison Company, D.P.U. 94-150, at 6 (1994); Essex Gas Company, D.P.U. 96-121, at 5 (1997); The Berkshire Gas Company, D.T.E. 98-61/87, at 29-33 (1998).

The Company's purpose in issuing shares to effect the stock dividend is no different from the underlying purpose of the dividend-reinvestment plans approved in the past by the Department, i.e., since the Company is not paying out retained earnings to shareholders as a

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10 As indicated by the Company, the amount of the stock dividend payment to shareholders is not dictated by the level of retained earnings on the Company's balance sheet at the time that the dividend is declared (Tr. at 71-72). At the time that the dividend is issued, however, retained earnings reflected on the balance sheet (up to the value of the stock dividend) are reclassified to "Common Shareholders Equity," thereby representing a reinvestment of retained earnings in the operations of the Company (Exh. SU-15).

cash dividend, the cash generated from these earnings is available for reinvestment in utility property, plant and equipment.[11] Moreover, the payment of a stock dividend achieves the objective of a dividend-reinvestment plan in a more cost-effective manner for the shareholder, because the shareholder is able to increase his or her investment in the Company without incurring the tax liability that is incurred when a cash dividend is received. With the stock dividend, the shareholder incurs no tax liability until the share is sold at a future date, which may reduce the tax liability associated with the dividend for the shareholder.[12]

A second benefit of the stock dividend is that it gradually and predictably increases the number of shares that are available to be traded in the marketplace, which in turn increases the liquidity of the Company's stock (Exh. SU-1, at 7). In the past, the Department has approved stock splits for a number of utilities, which are designed to increase the marketability of a company's stock. The Department has found that the increased marketability of a company's stock will lead to increased investment in the utility, thereby facilitating future financing at a lower cost to the benefit of the utility's customers. See, e.g., Fall River Gas Company, D.P.U. 87-160/87-193, at 3-5 (1987); Fall River Gas Company, D.P.U. 93-147/93-172, at 7-8; Colonial Gas Company, D.P.U. 92 106, at 6-7 (1992). A key component of the Department's

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[11] It should be noted that the addition of utility property, plant and equipment is accomplished in a number of ways, including through the acquisition of utility operations.

[12] As the record shows, for income-tax purposes, the proceeds associated with the sale of stock received as a stock dividend will be treated as long-term capital gains rather than ordinary income, as long as the underlying stock upon which the dividend is granted has been held by the shareholder for a period in excess of one year (Exh. SU-1, at 7-8; Exh. SU-18). Since the long-term capital gain tax rate is significantly less than the ordinary income tax rate, shareholders have the opportunity to reduce their tax liability associated with any gain on their investment (id.).

approval of stock splits has been that: (1) the issuance of additional shares of common stock does not result in a change in the aggregate value of the utility's common stock; and (2) the utility is able to satisfy the net plant test. Id.

In this case, the record shows that an important objective of the stock issuance is to maintain the marketability and liquidity of the Company's common stock (Exh. SU-1, at 7). The Company has issued stock dividends for a number of years and the Company's shareholders desire and expect the payment of a stock dividend (Exh. SU-1, at 7; DTE-RR-6; Tr. at 64). As a result, the marketability of the Company's shares is linked to the Company's ability to maintain its stock-dividend policy. In addition, the gradual and predictable increase in the number of shares has the effect of enhancing the liquidity of the Company's stock.

Moreover, the record shows that the issuance of additional shares has no effect on the per-share par value of the Company's stock or on the total value of the shareholders' equity in the Company (Exh. SU-1, at 9; Exh. SU-3; Tr. at 75). The per-share par value does not change because retained earnings reflected on the Company's books at the time of the dividend are first applied to increase equity capital at a level equal to the par value of the stock issuance, with the remaining balance of retained earnings (up to the value of the dividend) being transferred to paid-in surplus.[13] In addition, the Company has demonstrated that following the issuance of up to 2.7 million shares of common stock, the Company's net utility plant will exceed its total capitalization, consistent with Department precedent (Exh. SU-3).

As the Company has indicated throughout this proceeding, the Company's policy of issuing stock dividends has significant value for both shareholders and customers. See e.g., Exh. SU-1, at 7; DTE-RR-6. The Company competes in capital markets with other utilities to attract both debt and equity capital. Many of the utilities with which the Company is competing issue cash dividends in order to maintain an investor base (and then finance their capital needs through stock or debt issuances). The Company's practice of issuing a stock dividend enables it to compete successfully in the equity markets by attracting investors who have a preference for stock dividends over cash dividends, and maintains the Company's ability to use the cash generated by earnings to improve and expand its utility operations, which reduces the level of financing that would otherwise be required by the Company (Tr. at 78, 80-81, 83-84). Accordingly, the issuance of 2.7 million shares of common stock for the purpose of a dividend payment to the Company's equity shareholders is reasonably necessary to accomplish a legitimate purpose in meeting the Company's service obligations, and therefore, should be approved by the Department.[14]

(…footnote continued)

[13] Because retained earnings are applied in this manner, there is no reduction in the par value of the Company's stock as would normally occur in with a stock-split. In addition, as a result of the reclassification of retained earnings to paid-in capital surplus, the reduction in the per-share book value of the Company's stock is significantly less than in the instance of a stock split.

[14] It should be noted that, although a change in the per-share book value of the Company occurs (both in relation to a stock dividend and a stock split), the aggregate levels of utility plant, property and equipment and capital remain unchanged. Accordingly, the Department has recognized that, regardless of any change in book value per share that results from the issuance of stock for a stock split, there is no impairment to the capital stock so long as the Company continues to meet the net-plant test. Because the stock dividend operates in the same manner as the stock split, this finding is equally applicable to the stock dividend in this case.

B. The Company Has Demonstrated That Its Net Utility Plant Will Exceed Its Total Capitalization Following the Stock Issuance.

The record indicates that, following the issuance of the 2.7 million shares of common stock necessary to effect the stock dividend, the Company's will have net-utility plant in excess of total capitalization of approximately $130,686,000 (Exh. SU-3). In calculating the Department's net-plant test, the Company incorporated a number of adjustments, which were approved by the Department in the Company's long-term financing case, D.T.E. 01-32. For example, the Company reduced the total amount of Property, Plant and Equipment reported in its consolidated balance sheet by $50,883,000 to reflect the removal of property, plant and equipment relating to unregulated business operations (Exh. SU-1, at 14-15; Exh. SU-4 (revised)). D.T.E. 01-32, at 10-11. Unregulated property, plant and equipment removed from the calculation of net-utility plant in service is supported by a combination of debt and equity, but having been incorporated over time into the Company's overall operations, cannot be directly attributed to a particular source of capital. Therefore, because it was necessary for the Company to make a reduction to its overall capitalization to correspond with the removal of unregulated plant from the net-utility plant-in-service calculation, the Company reduced debt and equity (both common and preferred) in the same ratio as those categories of capital have to the Company's total capitalization.[15]

Similarly, consistent with Department precedent, the Company excluded "additional purchase costs" totaling $733,921,000 associated with its acquisitions of local distribution operations from its calculation of net-utility plant in service (Exh. SU-1, at 15-16; Exh. SU-4 (revised)). D.T.E. 01-32, at 10-11. The Company's "additional purchase costs" are supported by a combination of debt and equity, and having been incorporated over time into the Company's overall operations, cannot be directly attributed to a particular source of capital. Accordingly, the Company reduced debt and equity (both common and preferred) in the same ratio as those categories of capital have to the Company's total capitalization.

Lastly, in performing the net-plant test calculation in Exhibit SU-3, the Company reduced its Long-Term Debt and Capital Lease Obligation by $123 million (or the $85 million outstanding balance as of June 26, 2001, plus the retirement of $38 million since March 31, 2001) to reflect the fact that the outstanding balance of the 364-day term loan is a short-term obligation, and therefore must be excluded from the calculation, consistent with the Department's treatment in the Company's long-term financing case. As indicated by the Company, the 364-day term loan was entered into by the Company in September 2000, in order to accomplish the acquisition of the New England gas companies (Tr. at 20).[16] As a result, the initial 364-day term of the loan pre-dates the Department's jurisdiction over the operations of Southern Union. Thus, for the Department's purposes, the date of issue is August 27, 2001, which is the effective date of the 364-day extension that the Company may elect

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(…footnote continued)

15 For purposes of applying the net-plant test in accordance with G.L. c. 164, § 16, the precise allocation of the reductions to capitalization are not critical because the comparison of utility plant is made to total capitalization.

under the terms of the loan. The Company must pay off, or convert to long-term debt, the outstanding balance of the term loan within 364 days, or no later than August 26, 2002 (Tr. at 21-22).[17] Accordingly, the remaining balance of the term loan of $85 million constitutes short-term debt under Department precedent and is appropriately excluded from the long-term debt calculation.[18]

It is also important to note that, although the issuance of the stock dividend has the effect of reducing the per-share book value of the Company when the dividend is issued, there is no reduction in the aggregate book value of the stock to the Company's shareholders because the shares are issued to all stockholders on a pro rata basis so that the relative percentage of ownership held by each shareholder is unchanged (Exh. SU-1, at 9; Exh. SU-3; Tr. at 75). This outcome is similar to a stock split, i.e., the total capitalization of the Company remains unchanged as a result of the stock issuance. The only difference in this case is that an adjustment is made at the time of the issuance to increase Common Stockholders' Equity by the

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16 For financial reporting purposes, the 364-day term-loan must be treated as a long-term obligation because the proceeds of the loan were used to finance long-lived assets (Exh. SU-1, at 14). Under Department precedent, "long-term" refers to obligations that are outstanding for a period of more than one year from the date of issuance.

17 If the Company were to decide to convert the remaining balance (currently estimated to be $85 million), or some portion thereof, to long-term securities prior to the expiration of the term loan, the Company would be required, under Department precedent, to demonstrate that it has net-utility plant in excess of capitalization to support that issuance.

18 To the extent that the Department includes the balance of this loan in the calculation of total capitalization, the record indicates that the unpaid balance at the hearing date was $485 million (less $400 million approved by the Department for conversion to long-term Senior Notes) (Tr. at 21). Therefore, even if the balance of the term loan was included, the Company would have net-utility plant in excess of total capitalization of approximately $45,686,000, and therefore, would satisfy the net-plant test.

amount of retained earnings on the Company's books (up to the value of the dividend). Since the Company has demonstrated that its net utility plant is in excess of its capitalization following the issuance, there is no impairment to the Company's capital stock as a result of the reclassification of retained earnings to Common Stockholders' Equity. In fact, the reinvestment of net earnings in the Company's operations will tend to increase the level of net utility property, plant and equipment on an annualized basis (DTE-RR-1).

As discussed above, the Company has demonstrated (consistent with the requirements of the Department's net-plant test) that its net utility plant equals or exceeds its total capitalization and will continue to do so following the proposed issuance, pursuant to G.L. c. 164, § 16. See New England Power Company, D.T.E. 00-53, at 10; Boston Edison Company, D.T.E. 00-62, at 9-10. Therefore, the Department should authorize and approve the Company's request to issue up to 2.7 million shares of common stock.

VI. RESPONSE TO DEPARTMENT'S BRIEFING QUESTION

At the hearing, the Department posed the following question for briefing by the Company:

> Would it be appropriate for the Department as a condition of granting this petition to require that the Company exclude from its capital structure for ratemaking purposes the common shares of stock that are issued pursuant to Southern Union's stock dividend program?

Tr. 91-92.

There are several reasons why it would not be appropriate for the Department to condition approval on the exclusion of the common shares of stock that are issued as dividend payments to shareholders from the Company's capital structure for ratemaking purposes. First, this is not a ratemaking proceeding and decisions relating to the Company's capital structure cannot be made without an evaluation of the Company's overall capital structure and resulting cost of capital. The Company acknowledges that, as a general rule, equity is a more expensive source of financing than debt. This general proposition, however, does not support the conclusion that a company that issues a stock dividend will have a "weighted cost of capital that is somewhat higher as a result of [the] stock dividend policy" (Tr. at 76).

In between ratemaking proceedings, utilities routinely take a number of actions that affect and shape the overall capital structure of the company and the resulting debt/equity ratio. Thus, the fact that a company issues a stock dividend does not necessarily mean that the company's overall capital structure will be weighted more heavily by equity in the final analysis. As a result, an inquiry by the Department in a ratemaking proceeding would focus on the relative amount of debt and equity reflected in a company's capital structure and not on the many actions taken by the utility since the previous ratemaking proceeding, which have produced the debt-to-equity ratio under consideration by the Department. In the past, where the Department has determined that the overall capital structure is inappropriate, the Department has adjusted the capital structure for ratemaking purposes. See, e.g., South Egremont Water Co., D.P.U. 95-119/95-122, at 24 (1996).

Moreover, the record shows that a primary objective of the stock dividend is the reinvestment of retained earnings in the Company to fund capitalizable additions and improvements, which has the effect of reducing the Company's need for long-term financing through other equity or debt issuances (Tr. at 78). The stock dividend proposed by the Company represents a cost-effective means of raising additional capital to fund utility operations in that it avoids issuance costs and because it presents tax advantages for investors, which improves the Company's overall attractiveness in capital markets, thereby helping to reduce the Company's overall cost of capital. Therefore, it may be that, on an overall basis, the Company's cost of capital would be lower than other utilities that pay cash dividends from retained earnings and then enter into long-term financing arrangements to fund capitalizable additions and improvements.

For these reasons, the Department generally evaluates a company's cost of capital only in the context of a ratemaking proceeding where all of the factors affecting the Company's cost of capital can be considered and accounted for. As a result, it would be not be appropriate for the Department to make any determinations in this proceeding regarding the impact of the stock issuance on the overall capital structure, nor does the record for the proceeding provide a basis for a reasoned judgment on this issue. Accordingly, the ratemaking implications of the Company's stock dividend policy should be considered by the Department only in the context of a ratemaking proceeding.

VII. CONCLUSION

The record in this proceeding shows: (1) that the Company's issuance of 2.7 million shares of common stock to provide a dividend payment to the Company's equity shareholders is reasonably necessary to meet the company's service obligations, pursuant to G.L. c. 164, § 14; and (2) that the Company's net-utility plant equals or exceeds it total capitalization (as calculated consistent with the Department's precedent on the net-plant test) and will continue to do so following the proposed issuance, pursuant to G.L. c. 164, §16. Therefore, for the reasons stated above, the Department should:

VOTE: That the issuance and distribution of up to 2.7 million shares of common stock as a dividend payment to Southern Union shareholders is reasonably necessary for the purposes for which such issuance and distribution has been authorized, pursuant to G.L. c. 164, § 14.

VOTE: That the issuance and distribution of up to 2.7 million shares of common stock as a stock dividend is in accordance with G.L. c. 164, § 16 in that the fair structural value of the Company's property, plant and equipment and the fair value of the gas inventories held by the Company, will exceed its outstanding stock and long-term debt.

ORDER: That the issuance and distribution of up to 2.7 million shares of common stock is approved and authorized, contingent upon a legislative amendment to G.L. c. 164, § 11 that allows for the distribution of a stock dividend if approved and authorized by the Department.

ORDER: That the issuance and distribution of up to 2.7 million shares of common stock is approved and authorized, contingent upon the Company's certification of a vote by the Board of Directors to authorize the stock issuance; and

ORDER: Such other and further orders and approvals as may be necessary or appropriate.

Respectfully submitted,

SOUTHERN UNION COMPANY

By its attorneys,

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Dated: July 2, 2001

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